

For release on delivery
10:00 a.m. EDT
October 14, 2003

Statement of

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Member

Board of Governors of the Federal Reserve System

before the

Committee on Banking, Housing, and Urban Affairs

United States Senate

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I am honored to have been nominated by the President to serve a full term as a member of the Board of Governors of the Federal Reserve System. If I am confirmed by the Senate, I pledge to continue to devote myself to the pursuit of the objectives set for the Federal Reserve by Congress: maximum employment, stable prices, and moderate long-term interest rates.

I would like to take this opportunity to talk briefly about the prospects for the U.S. economy. After several false starts, the economy is showing signs of sustained recovery. The Bureau of Economic Analysis estimates that real GDP grew by 3.3 percent at an annual rate in the second quarter. Growth of real activity appears to have been even more rapid in the third quarter. Consumer spending, supported by expansionary monetary and fiscal policies, has remained strong. Notably, new housing construction hit record levels this year and will likely continue at a high level despite some increases in mortgage rates this summer. Particularly encouraging, however, are the signs of revival in capital expenditure by businesses. Investment in equipment and software, especially high-tech equipment, picked up noticeably in the second quarter and appears to be strengthening further. Rising sales and profits, easy financing conditions, and favorable tax provisions should support investment spending into 2004.

Although economic forecasting is far from an exact science, private-sector forecasters broadly agree that the economy should grow at nearly a 4 percent rate in 2004. I believe that forecast is plausible, assuming that the revival in business investment remains vigorous. Although there are certainly downside risks to that forecast, there are also reasonable scenarios under which growth next year might be higher than the 4 percent consensus, for example, if the rebuilding of inventory stocks is especially rapid or if economic growth among our trading partners begins to pick up significantly.

Although the increased growth rate of output is encouraging, everyone should be concerned that so far this growth has not translated into significant job creation. Until the job market improves, this recovery will not feel like a recovery to most Americans. A number of factors explain why we have not yet seen net new job creation. Two are particularly worth mentioning.

First, we have seen truly remarkable increases in labor productivity, which have permitted firms to meet the increasing demands for their output without hiring additional workers. This strong performance owes in part to the heavy investment in high-technology equipment in the latter part of the 1990s. Only over a period of time, apparently, have managers learned how to reorganize their production and distribution processes to take full advantage of the potential of these new technologies. The resulting increases in productivity have delayed the need to add new workers, but--it is important to note--they also imply that American firms and workers will be significantly more competitive, and that will help our economy preserve jobs in the long run.

Second, the past few years have been a period of heightened uncertainty, reflecting the aftereffects of the terrorist attacks of 2001, the wars in Afghanistan and Iraq, scandals in corporate governance, the unsettled state of the world economy, and other factors. Possibly because of these geopolitical and economic uncertainties, it appears that employers have been slower than usual to make commitments to expand their plants, add staff, or add to inventories.

Overlaying these cyclical factors is a continuing restructuring of the U.S. economy, one that has been going on for decades. Although restructuring is a persistent feature of our economic landscape, the displacement of workers and shifting employment patterns resulting from this restructuring are far more difficult to cope with in an environment of generally weak

labor markets than they were in periods of rapid employment growth. Inevitably, in a dynamic economy like that of the United States, the process of restructuring will continue and will present an ongoing challenge to American workers and employers. I believe, however, that the current weakness of the labor market is more cyclical than structural in nature, implying that aggregate employment will recover and unemployment will decline as the economic expansion matures.

The exact timing of the recovery in employment, however, is not completely clear. Modest encouragement can be taken from recent data on jobs creation, including increased hiring of temporary workers, often thought to be a leading indicator of more permanent hiring. Other indicators, such as the failure of the average workweek to expand in recent months and the very slow decline in new claims for unemployment insurance, are less encouraging, though they suggest at least some stabilization of the job market. However, in my view, the growth of productivity is likely to slow, at least somewhat, from its recent extraordinary pace, and so it seems very unlikely that firms can continue to meet rapidly rising demands without adding to their capital stocks (as they have already begun to do) and to their workforces. Thus, given the rate of increase in spending and output that we are now witnessing, a reasonable expectation is that firms will need to add significant numbers of workers within the next several quarters.

Where does this leave monetary policy? Inflation remains low, and the Federal Open Market Committee has indicated that the risks to inflation are to the downside. Thus, currently both the price stability and maximum employment objectives of the Federal Reserve point us in the same direction. Specifically, in my view, monetary policy can afford to maintain its accommodative stance for a considerable period, certainly until a sustainable recovery in employment is under way and disinflationary risks have been correspondingly reduced. I expect

that the continuing support of monetary and fiscal policies, together with the natural resiliency and strength of the U.S. economy, will in all probability lead ultimately to a sustained expansion without inflation, much as occurred after the so-called “jobless recovery” that followed the 1990-1991 recession.

I would be happy to take questions.